



Australian Government

Department of Infrastructure and Regional Development

Secretary

File Reference: TERR14/0055

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Joint Standing Committee on the National Capital and External Territories
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Dear Ms Edson

Departmental submission to the economic development on Norfolk Island inquiry


Thank you for the opportunity for the Department of Infrastructure and Regional Development to provide a submission to the Joint Standing Committee on the National Capital and External Territories' inquiry into the economic development of Norfolk Island.

The Departmental submission provides a summary of the current economic situation on Norfolk Island, desirable outcomes and outlines the Australian Governments' key priorities in improving the economic situation on the Island.

The Department looks forward to discussing its submission further at the upcoming Committee hearings in Canberra.

Yours sincerely

Mike Mrdak

 13 May 2014

*Department of Infrastructure and Regional Development Submission to
the Joint Standing Committee on the National Capital and
External Territories
Inquiry into the economic development on Norfolk Island*

The Department of Infrastructure and Regional Development (the Department) appreciates the opportunity to provide a submission to the Joint Standing Committee on the National Capital and External Territories' inquiry into the economic development of Norfolk Island. The Department, on behalf of the Australian Government, has a longstanding and ongoing role in assisting the Self Governing Territory of Norfolk Island achieve its outcomes and strategic directions. The Department, in partnership with other Australian Government Agencies, is also responsible for the management of Australian Government Assets on-Island that include land, parks and important heritage assets.

Overview

Norfolk Island is currently experiencing a severe economic downturn with the Gross Territory Product of Norfolk Island falling by approximately \$20-30 million (in 2011 dollars) between 1997 and 2011. The economic output of Norfolk Island reduced by more than 10 per cent between 2009 and 2010 thus putting the Norfolk Island economy well behind the economic baseline set in 1995-96 in both real and nominal terms. In contrast, the wider Australian economy saw more than five per cent growth in economic output over the same period.

There is limited up-to-date economic data available on the Norfolk Island economy and the Norfolk Island Government lacks both the capacity and resources to source economic data, which makes the effect and extent of the downturn difficult to measure. That said its economy has stagnated and continues trending downwards. The drivers of this decline are a mix of external factors beyond the control of the Norfolk Island Government coupled with inefficient and ineffective internal arrangements (governance and operational). There is evidence that the continuing economic downturn is impacting the quality of life on Norfolk Island.

Norfolk Island is a small, remote Australian community where significant capacity issues have resulted in the Norfolk Island Government's delivery of national and state type services being measured well below Australian standards (CGS, 2006). Norfolk Island's revenue base is presently too small to fund the breadth of its responsibilities, and this is compounded by inefficient service delivery arrangements. Further, a 2012 ACIL Tasman report concluded that it is unlikely that the Norfolk Island economy could ever provide a revenue base of sufficient size to fund the delivery of appropriate services and infrastructure. It should be noted that there is currently no system of municipal rates on-Island to pay for even the most basic of services such as household rubbish collection, but introduction of a rates system is a key Australian Government requirement.

The Island's ability to diversify economically and to attract new investment has been limited by the closed culture and monopolistic role of the Norfolk Island Government in the economy and the associated protectionist legislation that supports this role (ACIL Tasman 2012). The majority of its own legislation and regulations are antiquated and need modernising, streamlining and aligning with mainland legislation. Although the Norfolk Island Government has amended some legislation to encourage economic investment, this has largely been driven by the Australian Government.

Changes to legislation aimed at increasing immigration and investment have to date been only partially successful due to ongoing issues with Norfolk Island Administration's interpretation and management of the Norfolk Island Immigration Act.

Apart from the poor quality of infrastructure and lack of capital investment, further impediments to business investment include the high price of some utilities, including electricity, which is almost four times more expensive on-Island compared with the mainland; the current telecommunications network which is only equipped to handle 2G services and as such is inadequate for e-commerce and anything other than telephone and texting services; and the high cost of freight due to the Island's remoteness and lack of adequate sea port facilities.

The Australian Government is committed to working collaboratively with the Norfolk Island Government towards meaningful improvements to enhance the economic outlook for the Island and its residents.

Financial position of the Norfolk Island Government

The Norfolk Island Government is currently in a poor fiscal position and in 2013-14 is budgeting for an operating deficit in the order of \$5.2 million, while for 2014-15 deficit in the order of \$7.4 million is being predicted. Without Australian Government 'emergency funding' it would be bankrupt. This fiscal position has impacted significantly on Norfolk Island's ability to deliver services to its community and also implement practices and strategies for current and future economic development. There does not appear to be any improvement on the horizon.

The Global Financial Crisis in 2008 exacerbated a long term decline in the Norfolk Island economy, which resulted in reduced living standards and lower government service levels than any other regional Australian community. Over the last decade, the Norfolk Island Government has progressively exhausted its capital and cash reserves to fund service delivery and is now operating a significant and growing deficit.

Since 2010, the Australian Government has supported the Norfolk Island Government to ensure the continuation of essential services and to begin addressing its long term sustainability. It could be suggested that regular Australian Government financial support is creating a safety-net expectation within the Norfolk Island Government and maintaining its capacity and systemic problems. The Australian Government funding, however, has largely been provided on a targeted basis to provide support and basic services to the community on-Island and also assist with creating the economic settings to kick-start and stimulate the local economy. To date, Australian Government support has included:

- ongoing funding for the Norfolk Island Government's deficit through the provision of 'emergency funding';
- underwriting regular commercial air services between Norfolk Island and the mainland; and
- grants and loans to allow the upgrade of critical infrastructure.
- Ongoing support for Australian Government owned heritage assets including the Kingston and Arthurs Vale Historic Area (KAVHA).

In 2011, the Australian Government and Norfolk Island Government signed the Norfolk Island Road Map ('the Road Map') to formalise a set of reform goals across the seven areas of:

- Governance;
- Economic Development;
- Public Sector Management;
- Immigration, Health, Welfare and Education;
- Taxation;
- Environment; and
- Extension of Australian Government Laws to Norfolk Island.

Subsequent Australian Government funding has been tied to the completion of these goals.

While some progress has been made including in immigration reform, the audit of the Norfolk Island Government's 2012-13 financial statements, the Australian National Audit Office confirmed that the Norfolk Island Government is not a "going concern" and will be reliant on Australian Government funding of between \$7.4 million and \$7.8 million per annum over the forward estimates to make up its deficit. The amount does not include repayment of debts or capital provisioning to address the significant infrastructure backlog.

It is clear that the Norfolk Island Government is not able to fulfil the range of federal, state and local responsibilities for which it currently has responsibility. Most importantly, is not able to provide an adequate social safety net for its residents and this is having significant consequences for community health and welfare. The problems facing the Norfolk Island Government and community are well known and have previously been considered by the Australian Government in 2006 and 2011. Options to address these problems have also been extensively canvassed, but the solutions are neither cheap nor simple. The fiscal position of the Island needs to be rectified and sustainable government finances developed to underpin its future.

Australian Government key priorities

Since 2010, the Australian Government has increased its support to the Norfolk Island Government through targeted financial interventions to ensure the continuation of essential services and to allow it to begin addressing its long term sustainability. Economic development on Norfolk Island is an essential component of the reform process and despite increasing urgency to address the problems on Norfolk Island, progress against reform has been slow. While some simple reforms have been achieved or are underway, these are not sufficient to promote economic growth, increase government service levels or address the chronic underinvestment in infrastructure.

The key priorities for the Australian Government include:

1. improving the deficit position of the Norfolk island Government;
2. implementing measures to open markets and remove barriers to investment;

3. directly supporting efficient and reliable air services;
4. supporting the delivery of the waste management and Cascade Jetty projects, and addressing critical infrastructure gaps; and
5. maximising the economic impact of Australian Government assets through cultural tourism and improved Governance and increased Capital and Strategic Funding.

Each of these key priority areas is explored in further detail below.

1. Improving the deficit position of the Norfolk Island Government

The Australian Government's primary concern is addressing the Norfolk Island Government's budget deficit with complementary changes to governance, aimed at creating the right economic conditions for investment and increased economic activity. Without further direct action, deficits are predicted to increase in the absence of improved budgeting and planning, further controls on expenditure, and sustainable (and progressive) measures to increase revenue. Through the emergency funding agreement, the Australian Government is working with the Norfolk Island Government on the following measures to improve its deficit position:

(a) Managing costs

Controlling expenditure is a high priority in improving Norfolk Island's sustainability. The Norfolk Island Government is subject to cost pressures, like all other jurisdictions, yet it has not made difficult decisions to address them such as finding efficiencies to fund services to an appropriate standard, or moving to models of service delivery that are more appropriate for a small remote community.

In 2012, the Australian Government funded a capability development team to work with the Norfolk Island Government to assist in developing the skills and capabilities to better manage its finances and improve its governance arrangements. In addition, the Australian Government has employed a Commonwealth Financial Officer based on-Island to provide expert advice and assist with the management of Norfolk Island's finances. Under the Finance Ministers Orders (Norfolk Island), additional controls have been placed on expenditure. For example all expenditure in excess of \$50,000 incurred by the Norfolk Island Government requires the prior approval of the Australian Government. In addition, the provisions of the Funding Agreement place further controls on staffing levels within the Norfolk Island Administration.

These measures, when combined with the introduction of tighter controls on expenditure under Australian Government financial management and accountability arrangements will help underpin a framework to achieve the common goals of better financial management and sustainable government finances. Unfortunately, the Norfolk Island Government has not taken significant steps to address its sustainability and it remains dependent on Australian Government funding for its deficit.

(b) Increasing revenue

Increasing its current revenue base is critical in addressing the deficit position. In the absence of typical state and local revenue measures such as municipal rates and land tax, government revenue

is limited to a self-imposed Goods and Services Tax and income from service charges associated with Government Business Enterprises. These two sources account for around \$26.5 million per annum, but is offset against at least \$12 million in operating expenses. GBEs are also charging higher than desirable fees as they are being used as a general revenue measure to cross subsidise other activities rather than charging on a cost-recovery/fee for service basis.

As a condition of receiving ongoing financial assistance from the Australian Government in 2013-14, the Norfolk Island Government is required to introduce municipal rates and land taxes to raise additional revenue. The Norfolk Island Government has made some modest steps towards implementing municipal rates, but it is not clear there is sufficient time left to develop and implement a functioning rates system by 1 July 2014, as required in the present funding agreement. While municipal rates and land taxes are valuable alternative revenue sources, they are unlikely to raise more than approximately \$1.6 million per annum once fully operational.

In addition, the Commonwealth Financial Officer is assisting the Norfolk Island Administration in implementing ANAO recommendation around the recovery and management of GST revenues.

(c) Improving efficiency

Successive reviews have found that reform of the Norfolk Island Government's involvement within the local economy is needed to reduce costs, improve service delivery and facilitate more private sector investment.

Improving efficiency in its operations and Government Business Enterprises (GBEs) is another area where the Australian Government is providing assistance to the Norfolk Island Government, by commissioning an external review. The Norfolk Island Government operates a number of GBEs to provide a range of utilities and services that are wholly or partially provided by the private sector on the mainland, including liquor supply, electricity, telecommunications and lighterage (transferring cargo from ship to port via small tenders). The Norfolk Island Government operates these GBEs as unregulated monopolies. The revenue from these GBEs pooled in a consolidated revenue fund and thus used to cross subsidise other government activities, including loss-making GBEs.

Early indications from an Australian Government funded review of the GBEs indicates they are highly integrated with the Norfolk Island public service and have rundown assets, meaning they are not in a position to be privatised at this stage. However, there is potential for a process of restructuring of GBEs to improve efficiency and services with a view to preparing some GBEs for privatisation in the medium term.

Another area that should be examined to achieve efficiencies is the current suite of Norfolk Island legislation. Although the Norfolk Island Government has amended some legislation to encourage economic investment, the majority of legislation and regulations are antiquated and need modernising. A better legislative regime should include streamlining and harmonising with, or application of, mainland legislation.

(d) Public Sector reform

The 2011 Norfolk Island Road Map identifies the Norfolk Island public service as an important factor in the overall reform process. Reform of the public service is necessary to ensure it is well equipped to meet the needs of the Norfolk Island Government and community.

The capability of the Norfolk Island public services is extremely limited and the Australian Government deployed a review team for a short period in 2011 to begin addressing this problem. More recently, the Australian Government has funded the ANAO to audit the Norfolk Island Government's financial statements and provide recommendations for improved financial management. The Norfolk Island Government is yet to fully implement these recommendations.

The Norfolk Island Government has passed changes to its public sector legislation. However, it has been slow to enact appropriate policies, procedures and practices to give practical effect to these changes. Capacity building and succession planning within the public service remains an ongoing challenge. The ability of the Norfolk Island Government to implement reforms to its public service is extremely constrained due to a lack of appropriate skills and funding and it is unlikely to achieve meaningful change without significant Australian Government assistance.

The Australian Government has supported reviews of governance of the Norfolk Island Hospital Enterprise (NIHE) and these have identified a number of significant areas of potential reform. The NIHE represents a significant drain on the resources of the Norfolk Island Government, and recent cost blow outs coupled with the poor accreditation result on have highlighted the urgency of reform to the health care system.

2. *Implementing Measures to Open Markets and Remove Barriers to Investment*

In May 2013, and as milestone of a previous Australian Government funding agreement, the Norfolk Island Government developed a policy paper addressing a *Sustainable Growth Strategy for Norfolk Island*. The paper considered medium and long term perspectives and focused on the driver of population growth, future planning and changes to land use regimes. The paper was a step in the right direction but should be revisited and updated by the Norfolk Island Government to better target achievable strategic aims and goals but also include measurable and realistic outcomes. The recommendations in the paper made significant reference to Australian Government funding underpinning the achievement of outcomes, which is not sustainable in the medium to long term, all things being equal.

Currently Norfolk Island airport is an Australian external territory international airport and a passport or identification documents are required to travel to the Island.

The Australian Government is funding a two year pest and disease survey to better inform quarantine and border security arrangements that has the potential to open up niche agricultural markets. The survey is due for completion in December 2014 with the anticipated date for the final report in the first half of 2015. Dependant on the outcome of this report and noting the scattered and limited areas of productive land, small scale high yielding agricultural industries could be opened up creating economic opportunities for the Island. Accordingly, the survey results will also inform discussion on the possible extension of Australian customs, quarantine and the *Migration Act 1958* to Norfolk Island.

(a) Tourism

There are a number of internal factors which have accelerated the decline of the tourism industry and hampered a recovery including: high accommodation and event costs when compared to other overseas holiday locations close to the mainland (i.e. South-East Asia); difficulty in identifying as a destination of choice for the masses of Grey-Nomad groups travelling in Regional Australia in mobile homes and caravans; attracting new visitors and providing an ongoing variety of activity and entertainment to generate repeat visitation; ageing infrastructure (e.g. tourism, roads, telecommunications); and a lack of new investment and inadequate product offering in all areas including accommodation, retail, hospitality and events.

Visitor numbers have not improved substantially in recent years, and they are unlikely to do so until the above issues can be willingly addressed by the raft of on-Island stakeholders that have direct and indirect involvement in tourism activities. Even with action to fix the most critical barriers to increased tourism investment, structural factors such as increased competition in the region and better alternatives and better value for money elsewhere mean the Norfolk Island industry is highly unlikely to return to the pre-GFC model of consistently high numbers of visitors. Instead, the Norfolk Island tourism product will need to change to creating new growth opportunities and continually varied activities cruise ships, niche markets, cultural tourism, events, festivals and eco-tourism.

(b) Immigration promotion

Previously, Norfolk Island's immigration policy was to ensure that Norfolk Island remained somewhat closed and difficult for potential migrants to live and work on the Island. The 2011 Norfolk Island Census found that the permanent population had fallen by 12% and four percent since 2001 and 2006. The population decline exacerbates the economic situation as it reduces spending, decreases the tax base, lowers housing prices and worsens skills shortages on Island. The 2012 Economic Development Report highlighted the need for open immigration to support innovation and economic growth on the Island.

As part of the conditions attached to Australian Government emergency funding, the Norfolk Island Government has amended its immigration legislation to remove restrictions on Australian and New Zealand citizens residing and operating businesses on Norfolk Island with a view to reversing population loss. As a complementary measure, the Australian Government funded an Investment and Immigration Promotional Strategy.

3. *Directly Supporting Efficient and Reliable Air Services*

The Norfolk Island economy relies heavily on tourism. The tourism industry requires a reliable air service with the ability for global bookings to ensure that Norfolk Island remains an easy destination to visit. In addition, ticket prices need to be reasonable and affordable.

Since 2011, the Australian Government has committed to the underwriting of the current air services contract to Norfolk Island. This arrangement ensures regular flights between Norfolk Island and the mainland are maintained and the cost of travelling is reasonable. The Australian Government underwriting also provides certainty to tourism operators and other the businesses that rely on tourism and make up the Norfolk Island economy.

4. Delivering the Waste Management and Cascade Jetty Projects, and addressing critical infrastructure gaps.

An externally commissioned 2013 valuation found that almost 60 per cent of buildings owned by the Norfolk Island Government had an estimated remaining life of ten years or less, with no capital provision for their replacement. The local road network and electricity generation and distribution assets have also been neglected. The general condition of Norfolk Island's roads is poor and damage often takes years to repair.

The Norfolk Island Government has acknowledged that it does not have the capacity to modernise its diesel generator powered electricity network, which is fragile and places the community at risk of prolonged power outages. The addition of a solar program by the Norfolk Island Government, while good in theory, has not had the desired outcome as the additional power fed into the grid is more than it can handle. The power network is overloaded from this additional input and at risk of failing.

Creation of the right economic settings is largely reliant on infrastructure through improvement and maintenance of existing infrastructure; and investment and development of new infrastructure.

Without adequate infrastructure, investment opportunities on the Island are limited. What new investments in infrastructure have occurred, have been funded by the Australian Government via loans (with repayments deferred) or grants including an upgrade to the airport runway (total loans of \$12 million in 2003-06 – deferred payment and interest); a new waste management facility; and a new waste incinerator. The condition of the infrastructure on-Island is poor and is probably not far away from critical failure.

Sea access to the Island, a vital driver to the Island's economy, is impeded by poor landing facilities from both the lack of an all-weather port and physically inadequate facilities. Air access to the Island also suffers from weather problems but the Island is not big enough for this to be resolved (physically and operationally).

The Cascade Jetty has been identified as critically important to the economy of Norfolk Island and as such has been a major focus for improvement for some time. The Australian Government, in December 2013, committed \$13 million towards an upgrade and extension project. This funding is committed from an existing Community Development Grants program and will enable the strengthening, widening and extension of the Cascade Jetty. This will allow for the use of a mobile crane to be situated on the Jetty to unload cargo from barges and to raise and lower the barges into and out of the sea. These improvements will also include steps to allow large volumes of cruise ship passengers to disembark from the barges to the Jetty safely and efficiently while also reducing transport costs for cruise ships operators.

The development of new sea access facilities at other areas on-Island is not practical due to challenges including similar heritage concerns and/or difficult terrain. The Cascade Jetty, an Australian Government asset on the Eastern side of the Island, is the most appropriate to be improved for increased volumes of freight and goods, a variety of uses (including passenger cruise ships) and improved access.

5. Maximising the economic impact of Australian Government Assets through Cultural Tourism and improved Governance and increased Capital and Strategic Funding.

With tourism the main driver of economic growth on Norfolk Island, ACIL Tasman (2012) found that future economic development should largely concentrate on the tourism sector. The United Nations World Tourism Organisation's (UNWTO's) updated long-term outlook on future tourism trends states that international tourist arrivals worldwide is expected to increase by 3.3 per cent a year from 2010 to 2030 (UNWTO Tourism Towards 2030). This represents 43 million more international tourist arrivals every year, reaching a total of 1.8 billion arrivals by 2030. Specialist tourism and in particular cultural tourism are among the fastest growing sectors.

The Australian Government continues to upgrade its assets on Norfolk Island with the major focus on the World Heritage Listed KAVHA site. In addition to the annual appropriation, the Australian Government is funding further capital works including asbestos remediation. A review of the Conservation Management Plan is underway, along with website development looking at e-commerce and an educational tool which will raise the profile of this important Australian heritage site. A Cultural Tourism Strategy and Site Master Plan will also be developed with a view to improve the tourism experience and explore commercial opportunities. Work to reform the management arrangements for the KAVHA is underway, and should be completed shortly.